

THE MANAGER

PROFIT MANAGEMENT

By Tim Moag

Wise dairy farm managers intertwine strategies for income tax savings with those to improve the long-term financial health of their dairy and smart ways to use elusive profits

Profit from thoughtful tax strategies

Current tax laws, including tremendous depreciation incentives, provide Eastern dairy farm managers many opportunities to minimize 2011 income taxes.

The year has been ripe with difficulties: weather and cropping challenges, escalating feed prices which reduce the milk/feed price ratio, forecasted declines in milk prices and proposed changes to U.S. dairy policy. Dairy farmers remain cautious with regard to spending, not forgetting the low milk prices of 2009.

Managers need to consider continued price volatility and risk management in their tax planning process. Wiser dairy farm managers intertwine strategies for income tax savings with those to improve the long-term financial health of their dairy and smart ways to use elusive profits.

Income tax planning strategies

The complexity of tax laws and diversity of dairy farms in our region require tailoring tax planning strategies to minimize your dairy's income taxes. Here are some preliminary steps and tax planning tips dairy business managers should consider to reduce 2011 taxable income.

1. Project 2011 taxable income based on expected farm income and expenses.

- Use your bookkeeper and accountant to determine year-to-date results of operations.

- Project 2011 annual milk income based on expected pay prices and herd production. Also estimate other sources of gross farm income.

- Forecast 2011 year-end operating expenses and evaluate possible year-end capital spending.

2. Consider the opportunity to claim 100% bonus depreciation, immediately deducting new equipment and buildings with a depreciable life of 20 years or less placed in service through Dec. 31, 2011. The bonus depreciation is scheduled to be reduced to 50% in 2012.

3. Take advantage of

the opportunity to expense up to \$500,000 of new or used assets acquired in 2011 under IRS Code Section 179 for cumulative additions up to \$2 million. Congress has indicated the Section 179 deduction will drop to \$125,000 in 2012.

4. Evaluate potential deferral of milk income from 2011 to 2012, considering tax savings and future price forecasts. Producers must make an election with their cooperative to defer prior to producing the milk, i.e. Nov. 1 for December milk payments.

5. Follow IRS guidelines regarding documentation and limitations on prepaid farm expenses. Detailed invoices should identify a specific quantity and unit price vs. making a deposit on account. Weigh the potential credit risk of large advance payments to vendors vs. discounted prices for inputs and tax savings.

6. Take full advantage of IRS Code Section 199 domestic production deduction. Some milk cooperatives elect to pass through a share of their Section 199 deduction to members based on their proportionate share of hundred weights of milk shipped.

7. Self-employed taxpayers and S-Corporation shareholders may be able to deduct 100% of health insurance premiums paid as an adjustment to federal adjusted gross income. This deduction has been expanded to include coverage for a nondependent child under age 27 and Medicare Part B premiums.

8. Taxpayers engaged in a farming business as a sole proprietor, partner or shareholder in an S-Corporation may be able to use income averaging to calculate a lower tax on IRS Form 1040, Schedule J.

9. Consider any opportunity to recognize capital gain income before Dec. 31, 2012, at a favorable 15% federal tax rate.

10. C-Corporation farm entities should make

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■ Find more tax information at:

- The agriculture page at www.freedmaxick.com

- IRS Publication 225 Farmer's Tax Guide at www.irs.gov

- Cornell University's income tax website at <http://agfinance.aem.cornell.edu>



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effective use of the 15% federal tax rate on taxable income up to \$50,000 and the 25% federal tax rate on the next \$25,000 of taxable income.

11. Weigh tax planning decisions against a changing milk price cycle and the current record high purchased feed and forage costs.

12. Address tax planning and working capital needs by consulting with your lenders to have appropriate lines of credit for prepayment of expenses where it makes sense for business and tax reasons.

Long-term strategies for financial strength

Dairy farm managers would be wise to consider strategies designed to improve the long-term financial strength of both their farm business and family. The following list of tax strategies will help reduce income taxes but more importantly, grow funds for retirement, medical costs or education. They may also improve the overall financial well-being of your family.

1. Establish, increase or fully fund retirement plans – SIMPLE IRA's, 401(k) and pension profit sharing plans, etc. Deductions for 2011 could range from \$5,000 to \$22,000 for these retirement plans.

2. Consider adding a spouse or children to your payroll if they are performing work for the dairy. Pay management performance bonuses based on the business' financial success. These additional earnings may expand eligibility and provide funds to enhance retirement plan contributions.

3. Maximize contributions to Health Savings Accounts with 2011 contributions as high as \$7,150 for family coverage.

4. Research purchasing Long-Term Care Insurance which may be

deductible or qualify for tax credits.

5. Contribute up to \$13,000 into qualified Section 529 college savings plans. Some states allow a tax deduction for funding those plans.

Smart ways to use profits

Historically, many farmers have focused primarily on minimizing profits subject to income tax. The volatility of earnings leaves dairy owners uncertain as to when their business will next find itself with "extra" cash from profits.

The following ideas won't reduce taxable income but are prudent financial actions to better manage an economic downturn.

1. Pay down short-term operating debt and higher interest rate loans.

2. Hedge interest exposure, not expecting rates will move lower. Look at fixed interest rate options for some portion of farm debt.

3. Build short-term cash savings to act as a reserve for the next downturn, to provide equity for future land acquisitions or to fund a farm ownership buyout.

4. Take money out of the business to build long-term personal savings or investments outside the farm.

5. Accelerate life insurance premium payments. Such policies are integral to business transfer and estate plans.

Albert Einstein was a wise man who once said "not everything that counts can be counted and not everything that can be counted counts." Minimizing income taxes is an important objective but don't overlook some other choices that may enhance the long-term financial security of your farm and family. □

Are managers born or made?

Management is possibly the most important resource dairies have to deal with variability in earnings. Dairy farm owners and managers, through their ability to successfully perform a multitude of management tasks – to plan, staff, analyze, budget, implement decisions and communicate – greatly impact their business' ability to make money and manage profits.

Managers can be developed, and investing in their education to improve skills is one use of profits that can make a huge difference to your business.

In New York, two programs are ideal learning incubators for managers.

Cornell Dairy Executive Program

This executive-level management training program offers dairy producers the opportunity to improve their leadership skills and management acumen. Working with world-class instructors, CDEP members perform a comprehensive evaluation of their businesses and develop strategic business plans, among other activities, during three one-week-long sessions over a year's time.

In total 190 dairy and agribusiness managers from 22 states have completed the CDEP since it began. New classes enroll by the first of November each year, with the program starting in December and

finishing the following December.

For information on the CDEP, see this website:

www.ansci.com/prodairy/dairyexec.index

Academy for Dairy Executives

This management training program targets those dairy producers who have just moved into management roles and are interested in developing key management skills. The Academy, piloted across northern New York through the collaboration of PRO-DAIRY, the Northern New York Extension Team and the Northern New York Dairy Institute, offers three two-day sessions over 10 months.

The sessions focus on budgeting, financial ratios, leadership styles and building advisory teams, among other topics important to up-and-coming managers.

The Academy will be offered in 2012 in eastern New York as PRO-DAIRY partners with the Cornell Cooperative Extension Capital Area Agriculture and Horticulture Program. The dates and locations are Jan. 11-12, 2012, Albany; March 14-15, Lake George; and Nov. 14 -15, Cooperstown.

For information on the Academy and an application, call 518.746.2560 or 518.380.1498. Or go to this website: www.ansci.cornell.edu/prodairy/academy □